

February 27, 2006

EX PARTE

Ms. Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W., Room TWM-204
Washington, DC 20554

**Re: Ex Parte Filing of IDT Telecom, Inc. on USF Methodology Reform;
CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170.**

Dear Ms. Dortch:

IDT Telecom, Inc. ("IDT" or "the Company") supports not only reform of the Universal Service Fund ("USF" or "Fund") contribution methodology, but also reform of the assessment methodologies for the other funds and fees that rely on the Form 499-A.¹ Moving the USF alone to a number- and connection-based methodology would increase carriers' reporting burdens and perpetuate the problems of the existing revenue-based methodology for the other funds and fees. Additionally, a hybrid number-revenue based system is equally burdensome and inequitable. Therefore, IDT urges the Commission to reform the contribution methodology for all funds and fees that are calculated using revenue reported on the Form 499-A.

About IDT

IDT Corporation is a \$2.4 billion company that provides a variety of communications, entertainment and media services. IDT Corporation, through its IDT Telecom, Inc. subsidiary provides communications services including local and long distance services, carrier's carrier services, prepaid wireless services, and prepaid calling cards.

IDT's core product is prepaid calling cards, with a particular emphasis on international calling. These cards offer not only basic voice services, but also access to certain enhanced features such as stock quotes, sports scores and movie times. Because of IDT's international focus in its core product, IDT also offers extensive international wholesale. These carrier's carrier services are sold both as circuits and switched services, either on a fixed capacity or

¹ In addition to USF, the Form 499-A is used to calculate the Telecommunications Relay Service ("TRS"), support to the North American Numbering Plan Administration ("NANPA"), Local Number Portability ("LNP"), as well as portions of the FCC's regulatory fees.

minute of use (“MOU”) basis. IDT’s local telephone services product typically come bundled with basic long distance, certain vertical features (such as call waiting), and some discounted international calling, as IDT’s customers tend to have a greater international calling percentage than the industry as a whole. Consistent with IDT’s focus on the international calling market, IDT’s newest product, a prepaid wireless service, offers favorable international rates.

IDT’s USF Contributions

Because IDT provides this diverse array of services and products, the Company can inform the Commission as to how a change in the contribution methodology will qualitatively affect contributions to the Fund on numerous services and products. The result is clear that under either system, IDT will continue to contribute to the USF. For example, as a provider of bundled local and long distance services and prepaid wireless services, IDT assigns telephone numbers to its customers. Presently, IDT contributes to the USF based on the end user revenue component of its bundled services. As the services are bundled, allocations of revenue are made as between local and long distance service. As the Commission noted in beginning this rulemaking, the industry-wide transition to bundled services can be a factor in the decline of the contribution base as revenues are allocated among different jurisdictions, whereas a numbers-based system would likely be more stable over time, as the number of lines does not significantly fluctuate. If a number-based contribution methodology were adopted, IDT would make contributions based on these working telephone numbers, and IDT would continue to contribute on these services.

For its carrier’s carrier services, IDT would typically not contribute to the Fund because USF is assessed only on revenue from sales to end users. It should be noted that under the existing revenue-based system, the current Form 499-A reclassifies some carrier’s carrier revenue as end user revenue, depending on whether or not the purchaser is a USF contributor, even if that purchaser is another carrier, and not a true end user customer. Such actions are contrary to Commission regulations and precedent which require the Universal Service Administrative Company (“USAC”) to assess USF only on end user revenue. As numerous comments in this proceeding have noted, a connection-based system must continue to assess only on end user sales to avoid any competitive inequities as between facilities-based and resale carriers. IDT echoes these concerns, and believes that any connection-based USF methodology must define with precision “end users” of assigned numbers and assessable connections.

Similarly, as a provider of prepaid calling cards and prepaid wireless services, IDT uses telephone numbers (both local and 800), circuits, and MOU capacity acquired from other carriers to offer prepaid calling services that are bundled with information services, and for resold prepaid wireless services. As with the carrier’s carrier revenue discussed above, any number- and connection-based USF methodology must address whether IDT would be treated as an end user for purposes of these component purchases.

The Current 499 Reporting Methodology Is Rife with Inequities and Must Be Reformed

The current revenue-based USF contribution system is broken for a number of reasons. Reform of the USF methodology is therefore essential. While many other parties have addressed

the problems inherent in the current methodology, IDT's prepaid and largely international business gives it a unique perspective on the significant inequities with the current USF contribution methodology. In addition to the specific problems with the revenue-based methodology discussed in this proceeding, the revenue-based system has created numerous general inequities that can be remedied with a change in methodology.

As an example of these more generalized issues, the Commission's case-by-case information service classifications make it difficult to predict whether self-classification of a particular service as an information service will be upheld on review by USAC or the Commission. A number/connection-based methodology is technology-neutral and thus not subject to issues regarding the classification of products as either telecommunications or information. As another example, the Limited International Revenue Exemption ("LIRE") is arbitrary and discriminatory, as it creates inequities in the international calling market. While the statute clearly does not allow the assessment of USF on largely or entirely international carriers,² the statute's requirement to assess USF on an equitable and non-discriminatory basis should require that all international revenues be exempted from contribution. Because LIRE is an "all-or-nothing" proposition, the regulation unduly impacts business decisions and imposes inequitable penalties on carriers that cross the current 12% interstate threshold. A number/connection-based methodology eliminates this problem by treating all international services equally.

Further, the current "face value" reporting instructions discriminate against prepaid calling card providers. Only prepaid calling card providers pay USF on revenue they never collect. Other carriers contribute USF only on collected revenue, by deducting revenue which is not actually collected in Line 423 of the Form 499-A.³ The result is that prepaid calling card providers pay a higher effective USF rate than all other contributors. For example, on a \$10 face value card, the provider might sell the card at only 70% of the face value to the card distributor. Thus, if the provider contributes on the full face value but collects only 70% of the value, the effective USF rate is over 15%. In addition to these inequities, the current system is unduly burdensome on calling card providers. The current Form 499-A reporting instruction requiring reporting prepaid calling card revenue based on calling card activations conflicts with Generally Accepted Accounting Principles, imposing additional record keeping burdens on prepaid calling card providers.⁴ With a number/connection based approach, these issues also disappear and allow the Fund to become more equitable across different telecommunications services.

² *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 434-5 (5th Cir. 1999).

³ 47 C.F.R. § 54.706(c).

⁴ In addition, the Form 499-A instructions contradict I.R.S. guidelines regarding reporting of calling card revenue for federal excise tax purposes. The I.R.S. regulations require reporting of the sale of a card at the time it is sold from a carrier to a non-carrier, not at time of activation. 26 C.F.R. § 49.4251-4.

In addition to the above examples, both facts and economic theory show that the current revenue-based system should be replaced. First, the USF contribution base declined by 5% between 2000 and 2003.⁵ This declining base threatens the sufficiency of the Fund. Second, the Congressional Budget Office (“CBO”) has found that a flat fee that is insensitive to use, such as a number- or connection-based fee, would distort consumer choice less than the current revenue-based fee does, making it a more equitable system.⁶ In sum, it is time for the Commission to enact comprehensive reform that fixes the inequities of the current system, makes it easier for carriers to report and USAC to administer, and reduces the impact USF and other funds/fees have on consumers’ purchasing decisions and carriers’ business plans.

The Commission Should Base Contributions on a Combination of Working Telephone Numbers and Non-Switched, High Capacity Connections

Based on the observations above, IDT endorses the “number-based” approach to assessment favored by many other carriers, as well as Chairman Martin. The number-based approach meets the Commission’s stated goals in the proceeding of increasing the stability of the USF system while also making the assessments equitable and non-discriminatory as required by Section 254(d) of the Act.⁷ Further, IDT endorses also assessing USF on non-switched, dedicated “connections” such as DSL, cable modem and other high capacity circuits that do not use telephone numbers.⁸

As noted above, defining the class of non-switched, high capacity connections that are subject to assessment must be done with some care. The current 499-A instructions unlawfully attempt to reclassify certain wholesale revenues to end user revenues for purposes of USF assessment. Because the current instructions are often amended to impose substantive changes on filers without notice and comment, IDT agrees with those parties that advocate a further notice to define with specificity the details of any number/connection-based assessment methodology the Commission adopts.

Creating a Hybrid Number/Connection and Revenue USF Methodology Would Be Inequitable, Discriminatory and Administratively Burdensome

The Commission should not adopt a hybrid system that assesses USF on post-paid products under a number-based methodology and prepaid products on a revenue-based

⁵ *CBO Report* at viii.

⁶ *Id.* at 19.

⁷ 47 U.S.C. § 254(d).

⁸ IDT believes that assessing connections on a sliding scale, as proposed by the Inter-carrier Compensation Forum (“ICF”), could be a workable model in terms of creating different levels of contribution based on bandwidth. Although IDT does not endorse all aspects of the ICF proposal, it encourages the Commission to adopt an assessment methodology that imposes fund contributions on dedicated, non-switched lines as well as working telephone numbers.

methodology. Rather, the same methodology should apply to all products and all providers. Only a purely number/connection-based methodology can establish predictable and stable USF contributions in a manner that is equitable and non-discriminatory.

Any hybrid number/connection and revenue system would be inequitable for both carriers and consumers, administratively burdensome to carriers, and difficult to administer. For example, a hybrid approach would violate the principle that the assessment methodology should not drive customer purchasing decisions. If a consumer with a presubscribed long distance carrier has a choice between using that carrier for a long distance call and using a prepaid calling card to make a long distance call from home, the consumer would incur an additional fee if she chose to use the calling card. That additional USF fee from any revenue assessment on calling cards may deter the consumer from using the prepaid calling card, both influencing her purchasing decision and creating a competitive disadvantage for the prepaid calling card provider.

A hybrid system could also discriminate against certain classes of consumers, particularly low income consumers who tend to use prepaid services. Many consumers who place calling card calls do not have a home phone with a presubscribed long distance carrier. Instead, many of these calls originate from payphones. Under a hybrid approach, these calling card consumers would be assessed a USF pass-through by the calling card provider on the card revenue, effectively serving as a tax on usage. Conversely, a customer who places the same call from their home phone using their presubscribed long distance carrier would pay only the set monthly contribution for the actual phone number (and presumably billed by their local carrier), regardless of the length or number of calls they make. In effect, the same call using a presubscribed carrier causes no USF assessment. The result is that a heavy calling card user is likely to pay far more in USF pass-through than a heavy user of ordinary presubscribed long distance. Such a result is particularly troubling given that calling card users tend to be predominately low income, a class of customer that the USF has traditionally assisted.⁹ The Commission should ensure that one class of consumers, especially low income consumers, does not ultimately bear a much higher effective USF contribution than other consumers.

Such a hybrid system could also discriminate against prepaid calling card providers by requiring them to make multiple USF contributions on the same service. For instance, on a sale of a prepaid calling card to a customer, the provider would likely contribute based on the access number and potentially the connection used to provide the service, as large IXC's tend to consolidate traffic onto high capacity dedicated circuits for transmission to the prepaid calling card provider's platform. Assessing a USF contribution based on the prepaid calling card provider's revenue would add yet another layer of contribution on the prepaid provider. As such, a hybrid number/connection plus revenue assessment would violate the Act's requirement to assess USF obligations on an equitable and non-discriminatory basis. Such a hybrid system

⁹ The majority of IDT's cards have a face value of under \$10. While these calling card services are not entitled to receive low income support, the heavy use of these card by low income customers makes it essential, for the preservation and advancement of universal service, that calling card services do not pay an disproportionately high amount into the USF.

would assess one type of service—prepaid service—more than once, while not subjecting other, virtually identical services, to this additional contribution.¹⁰ Finally, a hybrid system would increase, not decrease, a filer's reporting obligations and USAC's administrative burden. It would also require the Commission to assign what portion of the total amount collected for the Fund should be allocated to the revenue-based assessment versus the number/connection-based assessments. Such an allocation would likely be arbitrary, as there would be no way to ensure that the allocation of contributions among carriers using two different contribution methods, could be done in an equitable and non-discriminatory manner, as required by law. Almost inherent in such a hybrid system would be the inequities of having different types of carriers contribute at different rates.

Many carriers who have resisted changing to a number/connection-based system raise concerns that such a change would cause a significant revenue shock to certain carriers and/or customers. To minimize such concerns, any change in methodology should be phased in over a period of approximately one year, or perhaps until the end of given contribution year.¹¹ Such a transition period is necessary not only to reduce contribution/rate shock, but also to allow carriers ample time to adjust their billing systems and rate structures and the Commission and USAC ample time to implement new forms and procedures. At the very least, the Commission should allow prepaid services sold to customers before the change in methodology to continue to be assessed on the existing methodology. Otherwise, carriers may be in a position of having sold a service to a customer, and then having a material change in the cost structure of the product occur. As such, extensive transition time, especially with regards to prepaid services, should be allowed.

If the Commission Maintains Any Revenue-Based Assessment, It Should Be Limited to Interstate Revenues

If the Commission nevertheless adopts a hybrid numbers/revenue system, the Commission should exempt all international revenue from assessment, and assess USF and other fees only on interstate revenue. Under the current USF system, but not other fund contribution systems, carriers who qualify for LIRE pay USF only on interstate revenue. The Commission adopted LIRE in response to the Fifth Circuit's *Texas OPUC Order*. The Fifth Circuit determined that assessing all international revenues of interstate carriers was "arbitrary and capricious and manifestly contrary to the statute."¹² The Court reached this finding because

¹⁰ The logical alternative, exempting 800 numbers from a number-based assessment, is no better. There are many different uses for 800 numbers, including prepaid calling cards, toll-free dial-up Internet access, residential 800 numbers for children calling home, etc. If the Commission starts trying to distinguish between what service a phone number is used to provide, it will lead to the same sort of arbitrage and illogical outcomes that the current system permits.

¹¹ In addition, to minimize the rate shock to prepaid wireless providers, the Commission may wish to include a requirement that working telephone numbers subject to assessment have revenue associated with them in any given month for which the assessment is made.

¹² *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 434-5 (5th Cir. 1999).

“COMSTAT and carriers like it will contribute more in universal service payments than they will generate from interstate service.” The Court also found that the Commission’s original interpretation of the statute was discriminatory “because the agency concedes that its rule damages some international carriers like COMSAT more than it harms others” without offering a “reasonable explanation of how this outcome, which will require companies such as COMSAT to incur a loss to participate in interstate service, satisfies the statute’s ‘equitable and nondiscriminatory’ language.”¹³

The adverse consequences of LIRE have never been subject to the same judicial scrutiny. For example, LIRE creates an inequity that penalizes carriers that reach the 12% threshold, requiring them to pay USF on 100% of their international revenue. The result is a competitive disadvantage for carriers who do not qualify for LIRE, relative to carriers who do. In conjunction with the “face value” reporting rule, LIRE also causes prepaid calling card providers to incur a loss in order to provide interstate service. These results, stemming from the Commission’s attempt to address the Fifth Circuit’s *Texas OPUC* concerns,¹⁴ are also inconsistent with the statute’s command to assess USF only on interstate revenue in an equitable and nondiscriminatory manner. Therefore, if the Commission preserves any form of revenue based assessment, it should assess USF on only interstate, and not international, revenue.

A similar argument applies to the Telecommunications Relay Service (“TRS”) fund. Section 225(d)(3)(B) requires the Commission to recover TRS costs attributable to the interstate jurisdiction from “all subscribers for every interstate service.” Like the USF, however, the TRS fund currently assesses both interstate and international revenues. Expanding the contribution base to subscribers for international services appears to violate the plain language of the statute. But, even if the statute or the Commission’s regulations could be read to support such an expansion,¹⁵ it suffers from the same flaws USF assessment on international revenues suffers. Assessment of TRS on international revenues damages some international carriers more than others and could require carriers to incur a loss in order to provide truly interstate service. Therefore, at a minimum, if the Commission chooses to maintain a revenue-based methodology for TRS, it should limit the revenue base to interstate revenues.

¹³ *Id.* at 435.

¹⁴ Although the Commission created LIRE to respond to the Fifth Circuit’s decision, the court never actually reviewed the legality of LIRE because COMSAT’s subsequent challenge to LIRE was dismissed on procedural grounds. *COMSAT Corp. v. FCC*, 250 F.3d 931, 937 (5th Cir. 2001) (dismissing COMSAT’s appeal for lack of standing/jurisdiction).

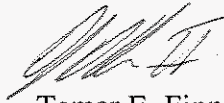
¹⁵ Given that the Commission’s regulations define revenues subject to TRS assessment as “interstate revenues,” it is not clear how or why the TRS fund was expanded to include international revenues. See 47 C.F.R. § 64.604(c)(5)(iii)(A).

This Docket Is Limited to Fund Contribution Assessment Methodologies

Lastly, IDT notes that this proceeding is limited to how monies flow into the Fund, and does not address monies that are disbursed from the Fund. Notwithstanding this procedural limitation, several parties, including ICF, have proposed various ways to increase support disbursed from the Fund. The Commission should defer these proposals to the appropriate docket and wait until it has had a chance to evaluate the effect of any methodology reform on the stability of contribution rates before expanding support further. If the reforms to the methodology prove successful in stabilizing the Fund, then the Commission should open subsequent proceedings to consider expanding the support provided by USF.

IDT believes that reform of the contribution methodology for USF as well as other funds is essential. To perform the Commission's stated aims of moving towards a stable and predictable contribution base, while still adhering to the statutory mandate to assess USF in an equitable and non-discriminatory manner, only a singular number/connection-based methodology will succeed. Any attempt to create a hybrid system that assesses providers based on both numbers/connections and revenue is bound to create inequities in the system and should be avoided.

Respectfully Submitted,



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